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ABSTRACT

This publication discusses areas of concern in the Department of Education's management and oversight of postsecondary student financial aid programs, especially the Federal Family Education Loan Program (FFELP), the Federal Direct Student Loan Program (FDSLP), and the Federal Pell Grant Programs. The General Accounting Office determined that, in 1992, the federal government paid out over $2.6 billion on defaulted student loans. To address underlying problems with federally guaranteed student loans, the Congress and the Department of Education required schools to develop plans to reduce defaults, implemented stronger enforcement tools, simplified borrower deferments, added repayment options, required lenders and guaranty agencies to share more of the risks and financial costs, provided for the 5-year phase-in of the FDSLP, reorganized the Office of Postsecondary Education, and began development of the National Student Loan Data System. However, assessment of the current situation suggests that these measures may not be adequate. Many of the Department's weak management practices caused by a complicated process, flawed structure, and mismanagement continue. The Department has not developed a strategic business or transition plan for phase-in of FDSLP, although implementation has begun. In addition, a significant growth in student loan demand from 1993 to 1994 may hamper implementation of the FDSLP. (Contains 12 references.) (JB)

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Student Financial Aid

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GAO **United States**
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

February 1995

The President of the Senate
The Speaker of the House of Representatives

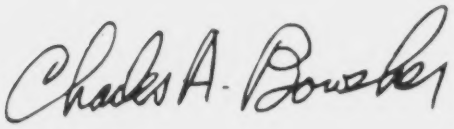
In 1990, the General Accounting Office began a special effort to review and report on the federal program areas we considered high risk because they were especially vulnerable to waste, fraud, abuse, and mismanagement. This effort, which has been strongly supported by the Senate Committee on Governmental Affairs and the House Committee on Government Reform and Oversight, brought much needed focus to problems that were costing the government billions of dollars.

In December 1992, we issued a series of reports on the fundamental causes of problems in designated high-risk areas. We are updating the status of our high-risk program in this second series. Our Overview report (GAO/HR-95-1) discusses progress made in many areas, stresses the need for further action to address remaining critical problems, and introduces newly designated high-risk areas. This second series also includes a Quick Reference Guide (GAO/HR-95-2) that covers all 18 high-risk areas we have tracked over the past few years, and separate reports that detail continuing significant problems and resolution actions needed in 10 areas.

This report discusses our concerns about the Department of Education's management and oversight of postsecondary student financial aid programs, especially

the Federal Family Education Loan, the new Federal Direct Student Loan, and the Federal Pell Grant Programs. We also discuss the programs' continuing problems and their root causes, and the initiatives in place to correct them. Because most of the initiatives are in the planning or the initial implementation stages, it is too early to evaluate their effectiveness. However, the results of our ongoing work lead us to question the adequacy of some of the initiatives that have been implemented.

Copies of this report series are being sent to the President, the Republican and Democratic leadership of the Congress, congressional committee chairs and ranking minority members, all other members of the Congress, the Director of the Office of Management and Budget, and the Secretary of Education.



Charles A. Bowsher
Comptroller General
of the United States

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Overview

In December 1992, we reported on guaranteed student loans, one of the program areas we considered high risk.[1] We reported that the Federal Family Education Loan Program (FFELP), formerly known as the Guaranteed and Stafford Student Loan Programs, succeeded in providing eligible students access to money for postsecondary education. But given the number of defaulted student loans, the program was less successful in protecting the financial interest of the federal government and the U.S. taxpayers.

The Problem

In 1992, the federal government paid out over $2.6 billion to make good its guarantee on defaulted student loans, continuing a trend of escalating losses. The causes of this lack of financial protection for taxpayers were many, but, in our 1992 report, we focused on several underlying problems with FFELP's structure and management:

- The structure was inordinately complex and participants had little or no incentive to prevent loan defaults.

[1]High-Risk Series: Guaranteed Student Loans (GAO/HR-93-2, Dec. 1992).

- Lenders that made loans and state designated agencies that guaranteed them against default bore little or no financial risk. Nearly all the risk fell to the federal government.
- The Department's management failed to establish adequate controls to minimize its losses and to correct several long-standing management weaknesses.

Although the Congress and the Department had attempted to correct these underlying problems prior to our December 1992 report, many of them persisted. We suggested actions to address these. We were also concerned that the Department's long-standing management weaknesses could hamper its implementation of the newly authorized Federal Direct Student Loan Program (FDSLP), which the Department expects to replace guaranteed loans by the end of fiscal year 1999.

Progress to Date

The Congress and the Department have made progress in addressing the underlying problems we identified in our 1992 report. Loan defaults have declined significantly—from $3.6 billion in fiscal year 1991 to about $2.4 billion in fiscal year 1994.

The reduction in defaulted loans began, in part, from an initiative the Department started in 1989 that required schools to develop plans to reduce defaults.

The Higher Education Amendments of 1992, which authorized FDSLP and reauthorized the federal student aid programs, allowed the Department to implement stronger enforcement tools. For example, the 1992 legislation requires financial and compliance audits of guaranty agencies to be conducted annually by independent auditors rather than every 2 years as before. Other new requirements in the amendments made changes that were also designed, in part, to help prevent loan defaults. For example, borrower deferments were simplified and repayment options added in an effort to provide borrowers opportunities to avoid defaulting on their loans when repayment was difficult. Further, the Omnibus Budget Reconciliation Act of 1993, which enacted the Student Loan Reform Act of 1993, required lenders and guaranty agencies to share more of the risks and financial costs of FFELP. And, most important, the 1993 legislation provided for the 5-year phase-in of FDSLP. With the implementation of FDSLP, some of the problems associated with lenders and guaranty agencies will diminish.

The successful implementation of FDSLP will be critical to ensuring continued loan access to eligible students as FFELP is phased-down over the next 5 years. As FDSLP gets under way, Department officials believe that the loan volume and profit margins of guaranty agencies will be reduced, causing some of the current 46 active agencies to withdraw from FFELP. In an effort to ensure a smooth transition to direct lending, the Department designated the Transition Guaranty Agency to manage insolvent guaranty agencies until another agency could assume the agencies' guarantee portfolios. The Department also contracted with the Student Loan Marketing Association to be the lender-of-last-resort to help ensure that eligible borrowers have access to guaranteed loans.

The Department has also reorganized its Office of Postsecondary Education, which is responsible for administering student financial aid programs, and is hiring and training staff to provide the necessary skills to better implement and oversee the various student aid programs. Finally, the Department (1) is in the process of developing the National Student Loan Data System, the first national database of information, by loan, on over 40 million student loans and (2) has prepared

departmentwide strategic and tactical information resources management plans.

Outlook for the Future

We are encouraged that during the 2 years since we issued our high-risk report, the Congress has strengthened student aid legislation and the Department of Education has undertaken a number of actions to address the concerns we identified. Although it is premature to evaluate fully most of these actions, recent work has caused us to question the adequacy of some of them. For example, in 1994, we reported that many of the Department's financial management problems identified during prior audits, such as inadequate financial information and unreliable loan data, continued.[2] We also reported that the Department was lax in its monitoring and oversight of foreign medical schools.[3] We found that loans were made to students attending foreign medical schools—schools that the Department failed to ensure met U.S. standards. In addition, the Department has not developed a strategic business or transition plan for its phase-in of FDSLP, although implementation has begun.

[2]Financial Audit: Federal Family Education Loan Program's Financial Statements for Fiscal Years 1993 and 1992 (GAO/AIMD-94-131, June 30, 1994).

[3]Student Loans: Millions Loaned Inappropriately to U.S. Nationals at Foreign Medical Schools (GAO/HEHS-94-28, Jan. 21, 1994).

Since 1992, we have reported that some of the problems in FFELP apply to the Federal Pell Grant Program and therefore, we are revising the definition of the FFELP high-risk area to include all student financial aid provided under title IV of the Higher Education Act of 1965, as amended. For example, in hearings conducted by the Permanent Subcommittee on Investigations, Senate Committee on Governmental Affairs, we testified on October 27, 1993, that schools have received Pell grants for students who never applied for the grants or never enrolled in or attended the schools.[4]

We have also identified an additional concern that could have an adverse effect on the Department's implementation of FDSLP—the significant growth in federal student loan demand. From fiscal year 1993 to fiscal year 1994, annual student loan volume increased from about $18 billion to approximately $23.8 billion (32 percent). This large increase in loan volume, coupled with the implementation of direct loans in July 1994, presents the Department with a challenge as it continues to implement corrective actions.

[4]Student Financial Aid Programs: Pell Grant Program Abuse (GAO/T-OSI-94-8, Oct. 27, 1993).

The legislative and administrative changes and revisions made to the gatekeeping process,[5] the information management systems, and the programs' themselves should, if properly implemented, reduce the risks in federal student assistance programs. But the advent of FDSLP, coupled with significant growth in student loan demand, could put a strain on the Department as it continues to address problems in FFELP and other student aid programs.

[5]Generally refers to the Department's procedures for determining which schools can participate—and whether they should continue participating—in federal student aid programs.

Student Loan Problems Caused by a Complicated Process, Flawed Structure, and Mismanagement

In our December 1992 high-risk report, we discussed the fundamental causes of problems in FFELP and recommended solutions to the Congress and Secretary of Education. We found three root causes of these problems: (1) the program's complicated, cumbersome process, (2) the program's flawed structure, and (3) the Department's mismanagement.

Operation of the Federal Family Education Loan Program: A Complicated, Cumbersome Process

FFELP continues to operate by a series of rules and requirements that affect millions of students and thousands of schools, lenders, and other entities. The program consists of a maze of responsibilities and encompasses the participation of five parties: students, schools, lenders, guaranty agencies, and the Department of Education.

Generally, students initiate the process by applying to a lender for a loan and arranging for repayment. Schools verify students' eligibility and ensure that loan amounts do not exceed students' cost of attendance. Lenders, following federal requirements, make the loans, and service and collect payment on them. If a borrower fails to make payments, the lender files a default claim with a guaranty agency. The agencies carry out several tasks, including issuing

guarantees, verifying that lenders properly service and attempt to collect loans, and remitting portions of moneys to the Department that may subsequently be collected from defaulted borrowers. The Department administers and oversees the program and the participants' activities. It also determines which schools can participate, establishes program requirements, pays lenders interest subsidies, and reinsures guaranty agencies for lender claims.

Program Structure Is Flawed

The structure of FFELP continues to be flawed. FFELP was initially targeted to middle-income students, generally a low-risk group. But its clientbase shifted to low-income students as the cost of education exceeded the amount of grants available to them, generally because of budget constraints. As a result, low-income students looked to FFELP to help finance their postsecondary education. A needs test was then established for loans. The test resulted in more low-income and fewer middle-income students being eligible for subsidized loans. It also meant that greater debt burden was placed on many low-income students, who often had little or no means to repay.

In addition, FFELP was originally intended to finance a traditional college education. The expansion of the program to include other education and training schools, such as proprietary (for profit) schools, resulted in loans being made to students to attend some schools that did not always provide a high-quality education. Many students attending these schools were also eligible for other kinds of federal student aid, such as Pell grants. Abusive practices of some proprietary schools, along with plentiful loans, had a disproportionate impact on loan defaults. For example, students who attended proprietary schools represented 23 percent of borrowers entering repayment in fiscal year 1992, but 45 percent of those that defaulted by the end of fiscal year 1993.

A fundamental tension exists within FFELP between its primary goal—providing access to a postsecondary education—and minimizing costs to the U.S. taxpayers. At the program's outset, the government expected to assume some of the financial risks for the program. But the government also expected that the states, as part of their responsibilities for participating in FFELP, would establish guaranty agencies to share the risk of defaulted loans. Few states, however, established such agencies. Most of

the risk was, therefore, absorbed by the federal government and U.S. taxpayers.

Prior to our 1992 report, the Congress and the Department took action to tighten the standards for school participation and to spread the risk beyond the federal government; however, the actions were insufficient. Also, to encourage participation, financial incentives were provided to lenders and guaranty agencies. But these incentives did not include initiatives to limit the federal government's financial exposure. The government was in the undesirable position of being financially liable for the actions of schools, lenders, and guaranty agencies, who had little incentive to control risk.

These structural flaws have been costly. Some students have been reluctant or unable to repay their loans. This is because some of them were pressured, by the lure of plentiful financial aid, to enroll in proprietary schools—some of which provided a poor-quality education and a bleak employment outlook. These students failed to get value for their money. Some schools, particularly proprietary schools, have been driven by a strong profit motive, with little concern for students' needs—completing their education or obtaining

employment—or for the frequency with which students defaulted on their loans. The schools lacked incentives to prevent students from defaulting, and thereby reducing their default rates.

Lenders and guaranty agencies, who had little financial risk, have, in part, been a contributing factor to the default problem. Federal loan servicing and collection requirements, which were detailed and prescriptive, were more form than substance. Had sufficient or adequate risk-sharing arrangements been in place, lenders and guaranty agencies could have had an incentive to pay more attention to the kinds of schools their students attended and the students' repayment practices.

Department Has Had History of Mismanagement

The Department of Education has had a history of mismanagement and poor oversight of FFELP's activities. For example, it typically (1) used ineffective procedures for determining which schools could participate, (2) had inadequate financial and management information systems that contained unreliable data, (3) conducted little oversight of lenders and guaranty agencies, (4) experienced high turnover in key management positions and failed to

employ staff with adequate skills, and (5) had a management structure that inhibited program improvements. Such mismanagement has been the subject of congressional hearings, reports by us and the Department's Office of the Inspector General, and other studies and evaluations. For example, in our audits of FFELP's fiscal years 1992 and 1993 financial statements,[6] we reported that, due to unreliable loan data (generally provided by guaranty agencies), we were unable to provide an opinion on whether the Department's Statements of (1) Financial Position, (2) Operations and Changes in Net Position, and (3) Budgetary Resources and Actual Expenses were fairly stated. However, we were able to determine that the Statement of Cash Flows presents fairly the cash flows of FFELP. In addition, the Office of Management and Budget (OMB) and the Department conducted a review concluding that the Department's management practices contributed to high rates of loan default, as well as fraud and abuse, in federal student aid programs.

This inventory of known problems in the administration of FFELP raises questions about the Department's ability to adequately manage the new FDSLP. Accurate financial

[6]GAO/AIMD-94-131, June 30, 1994.

and management information is needed for the Department to not only manage the existing FFELP, but to properly implement FDSLP.

Actions Initiated to Correct Problems

In our 1992 report, we recognized that congressional and Department improvements in FFELP were planned and under way, but concluded that other reforms and changes were needed. We provided suggestions for both the Congress and the Department to consider in addressing the problems and in enhancing the existing program. To a great extent, the Congress and the Department have been responsive to these suggestions, and many revisions in the law and changes to federal requirements, procedures, and practices have been or are being implemented.

It is too early to evaluate the effectiveness of most of these improvements because they have not been fully implemented.

Guaranty Agencies and Lenders to Bear More Financial Risk and Take More Responsibility

The 1992 and 1993 amendments require guaranty agencies and lenders to assume more of the financial risks associated with the default of guaranteed student loans. The statutory formula for paying lenders and guaranty agencies for defaulted loan claims was also changed.

Incentives to Assume More Risks Authorized

Prior to the 1993 amendments, guaranty agencies generally received 100-percent reimbursement from the Department for default claims paid to lenders. Guaranty agencies were paid reinsurance on the basis of a 100/90/80 percent formula: when a fiscal year's default claims were (1) under 5 percent of the agency's prior year loans-in-repayment balance, the reimbursement rate was 100 percent, (2) between 5 and 9 percent, the reimbursement rate was 90 percent, and (3) over 9 percent, the reimbursement rate was 80 percent. The amendments revised the formula to 98/88/78 percent, respectively. Therefore, the 1993 amendments' changes in the formula require guaranty agencies to share in the financial risk of all defaulted student loans.

In addition, prior to the 1993 amendments, lenders received 100 percent insurance for

the amount of loans (including principal and interest) that were in default. The amendments reduced the insurance rate to 98 percent. This change was made, in part, to require lenders to share in the financial risks of the program and to encourage them to work with borrowers to prevent their loans from defaulting.

Options in Place for Default Prevention

In order to prevent loan defaults, the 1992 amendments simplified the process for borrowers to help prevent them from defaulting. One change was to reduce the number of deferments available to student loan borrowers. Deferments are periods during which a borrower's payments of loan principal are postponed, and interest payments are made (subsidized) by the federal government. Deferments are intended to provide an opportunity to some borrowers to postpone repayment without becoming delinquent or defaulting on their loan. These borrowers include those in school or who have completed their education but are unable to begin repaying their loans. The amendments consolidated 13 different kinds of loan deferments into three: (1) in school, (2) unemployment (up to 3 years), and (3) economic hardship (up to 3 years). It is anticipated that this

simplification will encourage lenders to offer borrowers—and borrowers to request from lenders—deferment options that will help borrowers avoid default.

Gatekeeping Is Being Strengthened

The Department's gatekeeping procedures were subject to a number of changes to strengthen controls. To better enforce federal requirements and monitor schools, the 1992 amendments strengthened responsibilities for three major gatekeepers—states agencies, accrediting organizations, and the Department. The Department is also responsible for tightening its regulations and reorganizing its school certification and oversight activities.

State Postsecondary Review Entities Established

Although the Department has no regulatory power over states' licensing activities, the new legislation establishes federally funded state postsecondary review entities (SPREs). To establish a SPRE, which will be responsible for conducting or coordinating reviews of schools licensed in the state, the Department is to enter into an agreement with each state and may also provide federal funds to each SPRE to help pay for the reviews.

For a school that is eligible or seeks eligibility for federal student aid programs, the Department is responsible for conducting an initial review of the school and determining if it meets the statutory criteria requiring a review. Following its review, the Department notifies each SPRE of schools that meet one or more of the statutory criteria. The SPRE is then required to review the school. Based on its findings, or those of a federal entity (for example, the Department), a SPRE may determine that a school is ineligible to participate in student aid programs. Since SPREs are just beginning to be organized, it is too early to determine what effect they may have on gatekeeping.

Accrediting Organizations' Requirements Modified

The 1992 legislation strengthened existing requirements and provided for the Department's systematic review and approval of the organizations that accredit schools for purposes of student financial aid eligibility. The accrediting organizations are required to review and approve schools before students can receive student financial aid funds. Accrediting organizations, in conducting their reviews, must include among their approval criteria established Department priorities such as minimizing loan defaults, lowering the number of

students who drop out, and increasing placement rates for students completing their courses. Although these organizations assess a school's administrative capability and financial soundness, the primary focus of their reviews is intended to be educational quality—instructor qualifications, materials and equipment, curriculum, and student achievement.

Program Reviews More Focused

The Department is strengthening its processes for initiating and performing reviews of schools, in part, by establishing two types of program reviews: a standard survey review and a more comprehensive concentrated team review. A school is to be selected for a standard survey based on conditions such as having (1) 10 instances or more in which students received more than one Pell grant per payment period or (2) a significant increase in loans (30 percent or greater) and loan volume of at least $500,000 during a year. In a survey review, the reviewer examines the school's student aid policies, procedures, and records for inadequate financial records, inappropriate use of money advances for nonprogram purposes, or inaccurate expenditure reports.

If significant systemic violations are disclosed during a survey review (such as evidence of serious, recurring, or systemic problems), the reviewer is to recommend that a concentrated team review be conducted. Concentrated reviews are focused and should take no longer than 30 days to complete. In the past, program reviews, undifferentiated by type, were much broader in scope and coverage, and could take up to 2 years to complete.

Program Reviewers Being Hired and Trained

To help improve oversight over schools participating in federal student aid programs, the Department's Institutional Participation and Oversight Service—responsible for monitoring schools and determining whether schools are eligible to participate in the programs—hired 72 additional staff members to carry out reviews of postsecondary schools. In addition, 42 senior program reviewer positions were defined and approved, and are to be filled by November 1995. The Department also is increasing its training of reviewers by providing a 23-week training program for new reviewers and refresher-training for those on board. This training program includes basic administrative and personnel orientation and training in federal

procedures and structured on-the-job training in the regional offices.

Provisional Certification of Schools Authorized

The 1992 amendments allowed the Department to provisionally certify postsecondary schools to participate in federal student aid programs. This allows the Department to limit the length of time under which a school is approved to participate, and to more closely monitor and evaluate its performance. Provisional certification is expected to be used for schools with no history of administrative capability or financial responsibility for participation in federal student aid programs. This is generally the case for new schools or schools that change ownership.

According to a Department official, all new schools applying for certification to participate in any federal student aid program will be placed on provisional certification, allowing strict 2-year oversight prior to receiving final approval.

Management Practices Being Improved

The Department has been responding to recommendations of a 1991 joint study by OMB and the Department. This study found that management practices were a major

contributor to weaknesses in FFELP. The recommendations initiated a series of actions that the Department took, or is taking, to respond to these concerns.

The Department Reorganized Its Office of Postsecondary Education

In response to the study's recommendations, the Department completed a major reorganization of its Office of Postsecondary Education (OPE) to permit it to better administer and oversee federal student financial aid programs. OPE was reorganized to strengthen monitoring and oversight efforts and to enhance its efficiency. All of its offices with monitoring and gatekeeping responsibilities, which had been scattered among various OPE units, were consolidated. Placing all of these functions in one unit was intended to provide better coordination and permit more effective program management.

A new unit, responsible for overseeing guaranty agencies, lenders, and loan servicers was established within OPE. Its financial and program analysts comprise the Guarantor and Lender Oversight Staff (GLOS); their goal is to monitor guaranty agency and lender compliance with program requirements. GLOS staff also monitor other key factors affecting the financial health of guaranty agencies, some of which were

specified in the 1992 amendments and others are being developed by the staff.

Improved Oversight of Guaranty Agencies and Lenders

In the past, lenders and guaranty agencies were the subject of little oversight. The Department is improving its oversight of guaranty agencies and lenders with the creation of GLOS and by training approximately 21 GLOS staff members. The Department developed a task group to analyze guaranty agency review procedures and to identify more effective procedures for evaluating the agencies. For example, guaranty agencies must now arrange for independent financial and compliance audits to be conducted at least annually instead of biennially.

Actions Under Way to Make Information Systems More Responsive

Department information systems, the OMB study reported, were used to support a variety of student aid and financial operations, including ensuring the compliance of student aid recipients with federal requirements and the monitoring of student aid programs. But these systems contained unreliable data.

During the past 2 years, we have observed a clear commitment by top Department

management to identifying and correcting long-standing problems with system development efforts. The Department has taken the initial steps to develop major information management systems, such as the National Student Loan Data System (NSLDS), the Postsecondary Education Participants System, and the Direct Loan System. To reduce the likelihood of awarding student financial aid to previously defaulted borrowers, the Department implemented several data matches. For example, subsequent to a recommendation by its Office of the Inspector General, the Department began matching the names and social security numbers of financial aid applicants with similar information on the default tape to prevent defaulters from obtaining Pell grants or other financial aid.

A major Department initiative is its development of NSLDS, a national database of information, by loan, for approximately 40 million loans awarded to borrowers who participate in student financial aid programs. Such information is not readily available using the current database—the student loan data tape. The Department annually updates the existing database from data tapes the guaranty agencies provide to it, as of September 30 of each year.

NSLDS is being designed to provide the Department and the guaranty agencies with more detailed current and useful information and to help ensure that improved and accurate information is available on student loan indebtedness. The Department plans to update NSLDS monthly, based on detailed information received from guaranty agencies and schools. NSLDS is being designed to interact with other student aid systems, including the Central Processing and Pell Grant Recipient Financial Management Systems.

We reported in 1993 that our primary concern about NSLDS is that some data (which are the only data available) entered in the system will be erroneous, thereby compromising its effectiveness.[7] Subsequent to our 1993 report, the Department undertook a number of measures to try to protect the quality of the data initially loaded into NSLDS, and to improve the data quality long-term. For example, these measures include things such as (1) screening every data field sent to NSLDS to ensure that dates adhere to correct formats and character fields are only filled with letters and (2) tracking errors to the data field within

[7]Financial Audit: Guaranteed Student Loan Program's Internal Controls and Structure Need Improvement (GAO/AFMD-93-20, Mar. 16, 1993).

individual records once a guaranty agency's corrections are received at NSLDS. In addition to the measures above, a number of other activities were performed prior to NSLDS implementation to help improve data quality. For example, beginning in 1991, the Department conducted data quality reviews of guaranty agency databases, and identified and reported specific data problems and corrections needed to the agencies for resolution.

Further, data are being loaded into NSLDS in the following order: (1) closed loan data, prior to October 1, 1989, from the FFELP database; (2) FFELP/Debt Collection Subsystem (DCS) data which contain historic records on Higher Education Assistance Foundation loans and loans assigned to the Department, along with data on loans currently active in the DCS; and (3) data provided by guaranty agencies and schools on all active loans and on any loans that entered a closed status after September 30, 1989. The Department believes that these efforts should help ensure that the most current data available on loans are loaded into NSLDS. Because the Department has not completed the implementation of NSLDS, it is too early to determine the effectiveness of these efforts.

Financial Management Improvements Under Way

Partly in recognition of problems identified in FFELP financial audits, the Department is taking a number of corrective actions. For example, it is revising the auditing processes and training of staff who carry out reviews of guaranty agencies and lenders. It is also (1) expanding the capability to do more in-depth financial reviews, (2) developing and maintaining detailed financial records, and (3) improving controls over information and financial management systems to safeguard assets, maintain the confidentiality of student loan data, and ensure the reliability of financial management information.

In our fiscal year 1993 financial audit of FFELP, we reported that many of the financial management problems identified during the prior year's audit still existed.[8] For example, student loan data that were generally provided by guaranty agencies and used by the Department were not reliable. Therefore, we were unable to express an opinion on whether FFELP's September 30, 1993, Statements of (1) Financial Position, (2) Operations and Changes in Net Position, and (3) Budgetary Resources and Actual Expenses were fairly stated. However, we

[8]GAO/AIMD-94-131, June 30, 1994.

were able to determine that the Statement of Cash Flows for this period was fairly stated.

To address the problem of unreliable student loan data, the Department has worked more closely with guaranty agencies in trying to understand and resolve some of the student loan data errors. In addition, the Department is continuing to develop NSLDS.

The Department is also developing guides for auditors to use in their audits of guaranty agencies and lenders. The guides will require external auditors to determine whether claims that guaranty agencies and lenders submit for payment to the Department are reasonable. The guaranty agency guide (which will be a revision to the previously issued guidance) is still under development with issuance anticipated in mid-1995; the lender guide is scheduled to be issued in February 1995.

Departmentwide Strategic and Tactical Information Resources Management Plans Are Prepared

The Department prepares annual departmentwide 5-year strategic and tactical information resources management (IRM) plans. The Department considers its plans to be blueprints that will support the improvement and development of information systems, and provide the capabilities employees require to carry out the Department's mission and to achieve its near-and long-term goals.

These plans are, in part, in response to our 1992 report[9] that found the Department (1) had not established an effective departmentwide IRM program, (2) had an ineffective strategic IRM plan, and (3) lacked key management and program information with which to effectively oversee its operations. We were also concerned that the Department's senior IRM officials had not been involved in strategic IRM planning and that the Department had failed to initiate a departmentwide information-planning process that identified the information needs of its programs, such as its student aid programs. As a result, we recommended that the Department develop an IRM plan that is linked to the Department's overall goals and objectives.

[9]Department of Education: Management Commitment Needed to Improve Information Resources Management (GAO/IMTEC-92-17, Apr. 20, 1992).

Because the strategic and tactical plans were recently developed, it is too soon for us to determine what effects they will have on the Department's student financial aid programs.

Further Action Needed

Student financial aid programs remain a high-risk area and require continued attention. This is so despite the Congress and Department having taken some actions to address problems such as billions of dollars in FFELP student loan defaults; ineffective oversight of schools, lenders, and guaranty agencies; and the lack of qualified staff. In particular, the following risks continue:

- Department gatekeeping practices continue to allow unscrupulous schools to participate in student aid programs.
- Department student loan data continue to be unreliable.

High-Risk Area Redefined

Since our 1992 high-risk report, we recognized that some problems associated with FFELP generally also apply to the Federal Pell Grant Program; therefore, we are revising the definition of our high-risk area to include all student financial aid provided under title IV of the Higher Education Act.

Federal Pell Grant Program Abuses Identified

In our 1993 testimony,[10] we reported on the use of false documents to support both

[10]GAO/T-OSI-94-8, Oct. 27, 1993.

schools' eligibility and students' Pell grant applications to participate in the Pell grant program. These schools submitted documentation to the Department for (1) students who never applied for grants, (2) individuals who never enrolled in or attended the schools, and (3) students who were ineligible. Some schools also misrepresented their academic programs and other eligibility criteria.

One of the first lines of defense in dealing with such problems—problems in schools participating in any student aid program—is to have strong gatekeeping procedures for ensuring that only schools that are able to provide the education they advertise can participate in the programs. Some of these procedures were strengthened in the 1992 amendments, although they were not in effect when the Department approved the schools mentioned above. We believe, however, that the 1992 amendments are a good start for strengthening the Department's approval of schools.

Implementing the Federal Direct Student Loan Program

In July 1994, the Department began the legislatively mandated 5-year phase-in of FDSLP to reach goals of: 5 percent of new student loan volume for the 1994-95 school

year; 40 percent for 1995-96; at least 50 percent for 1996-97 and 1997-98; and at least 60 percent for 1998-99. FFELP, with lenders and guaranty agencies, is expected to be phasing down during this period.

The Department met the goal of 5 percent of loan volume with 103 schools participating in direct lending during the first year. The first loans were made in July 1994, and the Department reports that the implementation is proceeding smoothly. Although these initial efforts have proceeded without major problems, there is no assurance that this success will continue as the program rapidly grows.

Our reports, as well as reports by the Department's Office of the Inspector General and others, have shown that inadequate planning and program management have kept the Department from properly managing its student aid programs. These concerns and others discussed in our December 1992 high-risk report, coupled with steadily increasing student loan volume, contributed to our suggestion that a comprehensive planning strategy is needed for the transition to direct loans. This strategy should address implementation issues such as training support,

income-sensitive repayment options, and loan default features; management and oversight over implementation; transition from guaranteed loans; and human resource and other Department support requirements.

The Department, in implementing direct lending, has not developed appropriate plans such as a comprehensive strategic mission or business plan, and a transition plan for FDSLP. The Department, however, has prepared individual task lists and other planning materials which contain elements that would be included in a comprehensive strategic plan. Specifically, these items include (1) training courses scheduled for Department and schools' staffs, (2) human resources and costs needed for the phase-in of and transition to FDSLP, (3) a transition strategy for lenders and guaranty agencies, (4) an acquisition schedule for the FDSLP subsystem, and (5) a FDSLP regulations schedule.

To its credit, in order to guide the implementation of the program, the Department addressed the management, staffing, and implementation of direct lending by assembling the Direct Loan Task Force. The task force is a temporary group which is responsible for the initial

implementation of FDSLP. It is comprised of staff from various offices, such as policy, accounting and financial management, and program systems. The Department chose a staff with diverse backgrounds, which provide the task force with the collective experience necessary to coordinate the implementation efforts.

Some of the problems associated with lenders and guaranty agencies also diminish with the Department's implementation of FDSLP. Under direct lending, the federal government is the lender and no intermediary provides a guarantee; therefore, lenders and guaranty agencies would no longer maintain their present role. However, lenders and guaranty agencies could operate as loan servicers (firms that perform loan servicing and collection) under contract with the Department.

For the first year (school year 1994-95), 103 schools were approved to participate in FDSLP. It is anticipated that about 1,400 schools may be added to the program in the second year. Without a viable strategy to guide the Department during the rapid increase in schools, the increases in loan origination and servicing, and the transition of schools leaving FFELP, the Department

risks not achieving its FDSLP mission and objectives efficiently and effectively. History has shown that the Department has experienced problems in operating its student loan programs, and it needs to continue to develop and formalize planning strategies and procedures to ensure that FDSLP does not meet with the same fate.

The Need to Correct Problems Is Critical

The need to correct the long-standing problems in FFELP becomes even more critical as (1) the volume of student loans continues to increase and (2) the Department, under FDSLP, increases the percentage of loans made directly to students. Otherwise, some of the same problems that are affecting FFELP could also pervade the new program and, with increasing loan volume, could continue to keep the government and the U.S. taxpayers at financial risk level. The Department must not allow direct lending to become a distraction as it continues the initiatives to correct the known problems in FFELP.

To help gain control over this high-risk area, the Department needs to ensure that the legislative and regulatory changes made to the gatekeeping process, information and financial management systems, and to the

programs themselves are effectively implemented. It also needs to continue to expeditiously improve the quality of its student aid data systems, especially NSLDS, as these systems are being implemented.

In an effort to ensure continued loan access under the FFELP and a smooth transition to direct lending, the Department designated the Transition Guaranty Agency to manage or take over insolvent guaranty agencies until another guaranty agency could assume the agencies' guarantee portfolio. The Department also contracted with the Student Loan Marketing Association to be the lender-of-last-resort to help ensure that eligible borrowers have access to a guaranteed loan. The Department not only must closely monitor its implementation of FDSLP and the transition from FFELP, it must also pay particular attention to ensuring that the Transitional Guaranty Agency and the lender-of-last-resort agreements are viable, thus ensuring that eligible students continue to have access to loans.

We recognize that the legislative changes and the Department's initiatives are steps in the right direction and, if they are implemented correctly, could improve the integrity of FFELP and all federal student aid

programs. However, because many of the initiatives are in the planning or initial implementation stages, it is too early to determine whether they will greatly reduce or eliminate the financial risks and other problems associated with the student aid programs.

Related GAO Products

Financial Audit: Federal Family Education Loan Program's Financial Statements for Fiscal Years 1993 and 1992 (GAO/AIMD-94-131, June 30, 1994).

Student Loans: Millions Loaned Inappropriately to U.S. Nationals at Foreign Medical Schools (GAO/HEHS-94-28, Jan. 21, 1994).

Student Financial Aid Programs: Pell Grant Program Abuse (GAO/T-OSI-94-8, Oct. 27, 1993).

Financial Management: Education's Student Loan Program Controls Over Lenders Need Improvement (GAO/AIMD-93-33, Sept. 9, 1993).

Direct Student Loans: The Department of Education's Implementation of Direct Lending (GAO/HRD-93-26, June 10, 1993).

Financial Audit: Guaranteed Student Loan Program's Internal Controls and Structure Need Improvement (GAO/AFMD-93-20, Mar. 16, 1993).

Department of Education: Long-Standing Management Problems Hamper Reforms (GAO/HRD-93-47, May 28, 1993).

Department of Education: Management Commitment Needed to Improve Information Resources Management (GAO/IMTEC-92-17, Apr. 20, 1992).

Student Loans: Direct Loans Could Save Billions in First 5 Years With Proper Implementation (GAO/HRD-93-27, Nov. 25, 1992).

High-Risk Series: Guaranteed Student Loans (GAO/HR-93-2, Dec. 92).

Student Loans: Direct Loans Could Save Money and Simplify Program Administration (GAO/HRD-91-144BR, Sept. 27, 1991).

Stafford Student Loans: Millions of Dollars Awarded to Ineligible Borrowers (GAO/IMTEC-91-7, Dec. 12, 1990).

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